

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

| | | |
|----------------------------|---|-----------------|
| PURCHASED WATER ADJUSTMENT |) | |
| OF ADAIR COUNTY WATER |) | CASE NO. 7026-1 |
| DISTRICT |) | |

O R D E R

On November 12, 1982, Adair County Water District ("Adair") filed its application with the Public Service Commission seeking approval of a purchased water adjustment clause and authority to adjust its rates for service in accordance with that clause. Adair's supplier, City of Columbia ("City"), has since the inception of its contract with Adair on June 11, 1982, raised the wholesale cost of water from \$.65 to \$.85 per 1,000 gallons. This represents a 31 percent increase over the previous rate charged to Adair.

Commentary

Prior to approving increased rates resulting from purchased water cost increases, pursuant to 807 KAR 5:067, the Commission must examine an applicant's financial condition to determine whether it can absorb any of the increased cost. If there is a potential for absorption, the Commission may adjust rates to offset only that portion of the increased water cost which cannot be absorbed.

Test Period

For the purpose of determining the reasonableness of the proposed purchased water adjustment and increase in rates, the Commission has adopted the year ending December 31, 1981, as the test period in this matter. Adjustments deemed proper and reasonable have been included to more accurately reflect current operating conditions.

Revenues and Expenses

Adair proposed to adjust revenues by \$40,626 to offset the increased cost of purchased water. No other adjustments were proposed. The Commission, after careful examination of Adair's financial condition, made the following adjustments to expenses in conformance with its rate-making policy to more fairly represent the actual operating expenses of Adair:

Purchased Water Expenses

Adair proposed to adjust purchased water expenses by \$13,936 to reflect the increased cost of water supplied by the City. The line loss experienced by Adair for the 12-month period ending September 30, 1982, exceeds the 15 percent maximum line loss allowed by the Commission. Adair is being reimbursed under warranty provisions of the construction contracts by United States Fidelity and Guaranty Company ("USFG") for all water loss in excess of 12 percent. Since Adair is being reimbursed for all water losses over 12 percent, the

Commission will use 12 percent as the maximum line loss allowed in this case. After adjusting the line loss to 12 percent, Adair's annual purchased water cost will decrease by \$6,222. The pro forma purchased water expense included herein for rate-making purposes is \$39,068⁽¹⁾ based on the maximum allowable gallons of 45,962,665⁽²⁾ and the wholesale water rate of \$.85 per 1,000 gallons.

Depreciation Expense

Adair accrued total depreciation expense of \$62,709 for the 1981 calendar year. This reflects depreciation on total plant using a composite rate of approximately 2.5 percent. It is a policy of the Commission to compute depreciation expense for rate-making purposes on the basis of the original cost of plant in service less contributions in aid of construction. The annual report reflects that the level of contributions in aid of construction at the end of 1981 was \$2,236,886 which is approximately 89 percent of the total cost of utility plant in service. In determining the pro forma depreciation expense the Commission has utilized the depreciation rates applied by Adair

(1) $45,962,665 \times \$.85 \text{ per } 1,000 \text{ gallons} = \$39,068$

(2) $40,447,145 \div .88 = 45,962,665$

and excluded depreciation associated with contributed property. This calculation results in a reduction in depreciation expense for rate-making purposes of \$55,811.⁽³⁾

Adjustments to the test period operations have produced the following results:

| | <u>Actual</u> | <u>Adjustments</u> | <u>Adjusted</u> |
|----------------------|-------------------|--------------------|------------------|
| Operating Revenues | \$132,036 | \$ -0- | \$132,036 |
| Operating Expenses | 166,503 | (62,033) | 104,470 |
| Net Operating Income | <u>\$(34,467)</u> | <u>\$ 62,033</u> | <u>\$ 27,566</u> |

Revenue Requirements

Adair's annual debt service based on outstanding debt at the end of 1981 is \$25,675. Using the pro forma net operating income established herein and including actual interest income of \$4,614 Adair would realize a debt service coverage of 1.25. The Commission is of the opinion that this coverage is sufficient to enable Adair to pay its operating expenses, meet its debt service requirements and maintain an adequate surplus, and that no additional revenue is required in this instance.

Summary

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

(3)
$$\begin{aligned} & \$2,236,886 \div \$2,504,216 = 89\% \\ & \$62,709 \times 89\% = \$55,811 \end{aligned}$$

(1) The purchased water adjustment clause sought by Adair is in compliance with 807 KAR 5:067, Purchased Water Adjustment Clause, is in the best interest of the public, and should be approved.

(2) The City has increased the wholesale cost of water from \$.65 to \$.85 per 1,000 gallons.

(3) After taking into consideration the above-mentioned adjustments to expenses, Adair should absorb all of the increased cost of water, and an adjustment of rates is not necessary to maintain Adair's financial integrity.

(4) The base rate for purchased water for future application of the purchased water adjustment clause should be:

| <u>Supplier</u> | <u>Rate</u> |
|------------------|-------------------------|
| City of Columbia | \$.85 per 1,000 gallons |

(5) The rates proposed by Adair would produce revenue in excess of that found reasonable by the Commission and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates sought by Adair be and they hereby are denied.

IT IS FURTHER ORDERED that the purchased water adjustment clause filed by Adair be and it hereby is approved effective on and after the date of this Order.

IT IS FURTHER ORDERED that for the purpose of future application of the purchased water adjustment clause of Adair, the base rate for purchased water shall be:

| <u>Supplier</u> | <u>Rate</u> |
|------------------|-------------------------|
| City of Columbia | \$.85 per 1,000 gallons |


IT IS FURTHER ORDERED that all provisions of Adair's tariffs not specifically mentioned herein shall remain in full force and effect.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Adair shall file its tariff sheet setting out the purchased water adjustment clause and base rate for wholesale water approved herein.

Done at Frankfort, Kentucky, this 28th day of January, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary